Monetary Policy Report

A regular meeting of the Board of Directors of *Banco de la República* took place in the city of Bogotá D.C. on Friday, June 30, 2017. In attendance were Mauricio Cárdenas Santamaría, Minister of Finance and Public Credit; Juan José Echavarría, Governor of the Central Bank; and Board Members Gerardo Hernández Correa, Ana Fernanda Maiguashca Olano, Adolfo Meisel Roca, José Antonio Ocampo Gaviria, and Juan Pablo Zárate Perdomo.

These minutes contain a summary of the outlook on the macroeconomic situation by the technical staff of the Central Bank (section 1), followed by a review of the main discussion regarding monetary policy by the Board of Directors (section 2).

Further detail on the macroeconomic situation prepared by the technical staff from the Central Bank will be presented in the monthly Monetary Policy Report for May 2017 and in the statistical annex. (Only available in Spanish).

1. MACROECONOMIC CONTEXT

1. With figures for the first quarter, the current account deficit of the balance of payments declined both in levels and as relative to GDP, compared to the same period of 2016 (from USD 3,546 million to USD 3,182 million, and from 5.9% of the quarterly GDP to 4.4%). However, unlike the previous year, the adjustment took place by an increase in revenues (mainly by mining exports) rather than by a reduction of outflows.
2. The information available for the second quarter suggests that the Colombian economy would have exhibited a low expansion, similar to that of the first three months of the year. On the supply side, the indicators for April and May suggest a higher-than-expected deterioration. On the demand side, private consumption would have remained weak, while investment would have accelerated *vis-â-vis* the results from the first quarter. Foreign trade would have contributed negatively to GDP growth.
3. On the other hand, banking credit to companies continues to decline, while the one granted to households has also reduced its growth rate in the last few weeks. This takes place within a context in which the transmission of the reduction in the benchmark rate has been higher to commercial credit rates than to household credit rates.
4. As for the labor market, with figures to April, there is a growing trend in the unemployment rate and stagnation in employment for the 13 areas, while the national total unemployment rate has

remained stable, and the number of jobs continues to grow, albeit at low rates.

5. In the external context, the Federal Reserve of the United States increased its benchmark interest rate, placing it between 1.0% and 1.25%. Additionally, it announced a contraction of close to a trillion US dollars on its balance sheet, which would be implemented gradually over the next few years.
6. Growth of the country's trading partners would continue to be supported by the behavior of advanced economies. Partners in the region maintain a very low dynamism.
7. There has been a downward trend in oil prices in recent weeks due to the news of higher inventories and to increases of production in countries which are not members of OPEC.
8. With this, downside risks, incorporated into the forecast range for GDP growth of the previous quarterly report (between 0.8% and 2.6%, with 1.8% as the most likely figure) seem to be materializing.
9. In May, yearly inflation posted at 4.37%. This reduction is explained by the behavior of food prices, tradable goods excluding food and regulated items, and regulated items. Non-tradable goods generated upward pressures, particularly leases, which have a high degree of indexation to past inflation.
10. Inflation expectations derived from the monthly survey to financial analysts applied in June exhibited a path slightly lower than the one obtained in the survey in May. Those embedded in public debt bonds also declined for most terms.

In all, for 2017, the strong transitory shocks that diverted inflation from its target are expected to continue fading in an environment of a weak economic activity. The monetary policy actions undertaken so far, which consider these effects, should strengthen convergence of inflation to its target.

2. DISCUSSION AND POLICY OPTIONS

The members of the Board agreed that the information published since the previous meeting of the Board of Directors shows that deterioration of the productive activity has been more pronounced than had been anticipated. Additionally, there are signs of deterioration in the growth of the financial system, which reflect this weakness of productive activity. On the other hand, the pace of inflation has continued to decline, although it is still above the target range, particularly in the case of the various core inflation indicators. Under these conditions, they agreed on the benefit of a further reduction in the benchmark interest rate to continue reducing the contractionary trend of the monetary policy.

Four Board Members voted for a 50 bp reduction of the benchmark interest rate. They considered that the prominent deterioration of productive activity and the negative expectations of economic agents regarding growth demand faster stimuli that contribute to economic recovery. In their view, although the inflation indicators still exceeded the target range, they have moved in the right direction.

The other three members of the Board voted for a 25-bp reduction to the benchmark interest rate. To their judgment, while deterioration of the productive activity requires a further reduction of the benchmark interest rate, the estimates by the technical staff of the Central Bank are still uncertain as to interest rate path consistent with the reduction of inflation towards 3.0% in 2018. Additionally, they also considered that a gradual reduction allows for better transmission of monetary policy.

3. POLICY DECISION

The Board of Directors of *Banco de la República* at this day’s meeting decided to reduce the benchmark interest rate by 50 bp, placing it at 5.75%. The decision to reduce the benchmark interest rate by 50 bp was approved by four (4) members of the Board. The remaining three (3) Board Members voted for a 25 bp reduction.

Bogotá, D. C.